

1 July 2019

United States

## EQUITIES

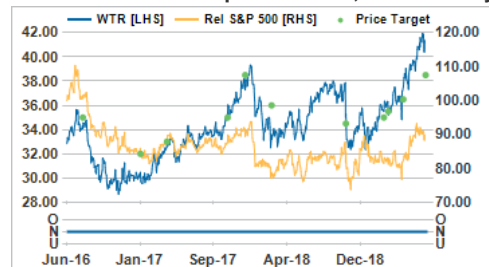
WTR US Neutral  
Price (at 03:06, 29 Jun 2019 GMT) US\$41.37

|                        |       |           |
|------------------------|-------|-----------|
| Valuation              | US\$  | 38.50     |
| - PER                  |       |           |
| 12-month target        | US\$  | 38.50     |
| 12-month TSR           | %     | -4.7      |
| GICS sector            |       | Utilities |
| Market cap             | US\$m | 8,925     |
| 30-day avg turnover    | US\$m | 40.8      |
| Number shares on issue | m     | 215.7     |

## Investment fundamentals

| Year end 31 Dec |      | 2018A | 2019E | 2020E | 2021E |
|-----------------|------|-------|-------|-------|-------|
| EPS adj         | US\$ | 1.41  | 1.30  | 1.51  | 1.65  |
| EPS adj growth  | %    | 4.5   | -7.5  | 16.0  | 9.1   |
| PER adj         | x    | 29.4  | 31.8  | 27.4  | 25.1  |
| Total DPS       | US\$ | 0.85  | 0.91  | 0.97  | 1.04  |
| Total div yield | %    | 2.0   | 2.2   | 2.3   | 2.5   |

## WTR US rel S&amp;P 500 performance, &amp; rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, July 2019

(all figures in USD unless noted)

## Aqua America (WTR US)

### Not all news is good news

## Key points

- Merger settlement is opposed by PAPUC's Staff.
- Peoples' gas settlement is only partial and doesn't seem to include a repair tax deduction.
- We remain on the sidelines, but boost TP to US\$38.50 from US\$36.50.

## Event

- WTR (and AWK) have benefitted from nationalization concerns surrounding UK water utilities. Regulatory updates on WTR's pending merger with Peoples have been mixed, and so far the utilities haven't received even a tentative approval to use a repair tax deduction at Peoples. The latter seems essential for WTR to offer a positive earnings surprise for 2020 and beyond.

## Impact

- Non-unanimous merger settlement:** In early June, WTR agreed to a settlement in the Peoples merger with all but two interveners in the proceeding. The Staff of the PA PUC (I&E) disputes Peoples' treatment of a rural gas system of 1,600 connections (Goodwin/Tombaugh Gathering System), which for years has experienced gas leaks. WTR has agreed to spend US\$120m in capex on the system and the spending would be recoverable through general rate cases. The I&E should present their position on the Goodwin/Tombaugh system on July 10, but for now we believe that the Staff wanted the system to be removed from Peoples' rate base and for the customers to be converted to propane, likely at Peoples' unrecoverable expense. WTR now expects an ALJ decision in late summer and the PAPUC decision by Oct/Nov.
- Gas rate case settlement:** On Friday, Peoples reached a settlement in its pending gas rate case in PA. The settlement happened sooner than we had expected, though cancelled rate case hearings in late June suggested a settlement was imminent. We are waiting for the settlement to be made public, but for now it's our understanding that a main line replacement was excluded from the settlement and will continue to be litigated. Also, the rate case settlement doesn't seem to include any references to a future election of the repair tax deduction, which is essential to accelerate WTR's EPS growth following the Peoples deal.

## Earnings and target price revision

- We updated our estimates to reflect the Peoples merger closing in late October. Our new '19/'20/'21 EPS estimates are US\$1.30/1.51/1.65 vs US\$1.47/1.54/1.62, respectively. We raised our TP to US\$38.50 from US\$36.50 to reflect a higher '21 anchor PEs for regulated water/gas utilities. Our new TP is based on 24.1x '21E water EPS plus 21.4x '21E gas EPS. Our previous TP was based on 22.8x '21E water EPS plus 21.0x '21E gas EPS.

## Price catalyst

- 12-month price target: US\$38.50 based on a PER methodology.
- Catalyst: Update on repair tax deduction for Peoples; 2019/2020 EPS guidance.

## Action and recommendation

- We reiterate our Neutral rating.

## Analysts

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Fig 1 WTR: EPS proforma pending Peoples merger

|   | 2019   | 2020         | 2021         | 2022         |
|---|--------|--------------|--------------|--------------|
| Water net income (US\$m)                              | 261.87 | 274.25       | 288.13       | 305.00       |
| Gas net income (US\$m)                                | 48.14  | 146.16       | 167.76       | 184.54       |
| Incremental parent interest expense after tax (US\$m) | -10.5  | -31.9        | -31.6        | -36.0        |
| Total EPS (US\$)                                      | 1.30   | 1.51         | 1.65         | 1.76         |
| S/O (m)   | 231    | 257          | 257          | 257          |
| EPS accretion vs standalone EPS (US\$)                | -0.17  | -0.03        | 0.04         | 0.06         |
| Water EPS   | 87%    | 71%          | 68%          | 67%          |
| Gas EPS   | 13%    | 29%          | 32%          | 33%          |
| Water EPS (US\$)                                      | 1.13   | 1.07         | 1.12         | 1.19         |
| Water PE multiple                                     |        | 25.3x        | 24.1x        | 22.8x        |
| Equity value of water per share                       |        | 26.95        | 26.96        | 27.11        |
| Gas EPS (US\$)  | 0.16   | 0.44         | 0.53         | 0.58         |
| Gas PE multiple                                       |        | 23.1x        | 21.4x        | 19.7x        |
| Equity value of gas per share                         |        | 10.27        | 11.33        | 11.37        |
| <b>Total equity value per share (\$)</b>              |        | <b>37.22</b> | <b>38.29</b> | <b>38.49</b> |

Source: Macquarie Capital (USA), July 2019

Fig 2 WTR: Financial projections (US\$ m except per-share data)

|   | 2018         | 2019E        | 2020E        | 2021E        |
|---|--------------|--------------|--------------|--------------|
| EBITDA                                    | 470          | 606          | 764          | 820          |
| EBIT                                      | 323          | 454          | 601          | 648          |
| Net interest expense                      | 99           | 125          | 163          | 162          |
| Ordinary Profit Before Tax                | 252          | 352          | 461          | 509          |
| Income tax                                | 1            | 51           | 73           | 85           |
| Net profit                                | 251          | 301          | 388          | 423          |
| <b>S/O (m)</b>                            | <b>178</b>   | <b>231</b>   | <b>257</b>   | <b>257</b>   |
| <b>Diluted EPS</b>                        | <b>1.41</b>  | <b>1.30</b>  | <b>1.51</b>  | <b>1.65</b>  |
| <b>DPS</b>                                | <b>0.85</b>  | <b>0.91</b>  | <b>0.97</b>  | <b>1.04</b>  |
| Cash                                      | 5            | 5            | 5            | 5            |
| Receivables                               | 101          | 128          | 148          | 156          |
| Inventory                                 | 14           | 18           | 18           | 18           |
| Other short-term assets                   | 16           | 16           | 16           | 16           |
| Other-long term assets                    | 801          | 801          | 801          | 801          |
| Property, plant, and equipment            | 5,808        | 6,206        | 6,473        | 6,731        |
| <b>Total assets</b>                       | <b>6,746</b> | <b>7,174</b> | <b>7,461</b> | <b>7,727</b> |
| Financial liabilities                     | 117          | 117          | 117          | 117          |
| Operating liabilities                     | 64           | 81           | 82           | 84           |
| Other liabilities                         | 108          | 108          | 108          | 108          |
| Deferred credits                          | 2,096        | 2,110        | 2,124        | 2,138        |
| Long-term debt                            | 1,975        | 2,254        | 2,248        | 2,489        |
| Shareholders' equity                      | 2,385        | 2,503        | 2,781        | 2,791        |
| <b>Total liabilities and equity</b>       | <b>6,746</b> | <b>7,174</b> | <b>7,461</b> | <b>7,727</b> |
| Net income                                | 251          | 301          | 388          | 423          |
| D&A, goodwill amortisation                | 147          | 152          | 163          | 172          |
| Other non-cash elements                   | 25           | 25           | 25           | 25           |
| Funds from operations                     | 423          | 478          | 577          | 621          |
| Non-cash working capital                  | 8            | 43           | 22           | 9            |
| Operating cash flow                       | 430          | 522          | 599          | 630          |
| Net investments in fixed assets           | -555         | -550         | -430         | -430         |
| Net investments in financial assets       | 0            | 0            | 0            | 0            |
| Free cash flow before dividends           | -125         | -28          | 169          | 200          |
| Dividends paid                            | -151         | -210         | -250         | -268         |
| Free cash flow after dividends            | -276         | -238         | -81          | -67          |
| Changes in capital                        | 2            | 2            | 2            | 2            |
| Changes in financial debt                 | 273          | 235          | 78           | 64           |
| Adjustment for minorities / miscellaneous | 1            | 1            | 1            | 1            |
| Increase in cash                          | 1            | 0            | 0            | 0            |

Source: Company data, Macquarie Capital (USA), July 2019

Other stock mentioned: American Water Works (AWK US, US\$116, Outperform, TP US\$121)

## Macquarie Quant Alpha Model Views

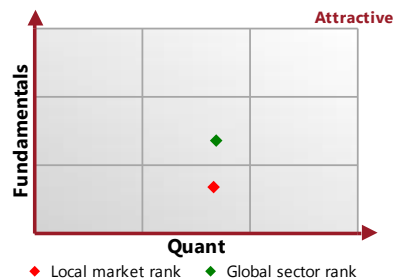
The Quant View page below has been derived from models that are developed and maintained by Sales and Trading personnel at Macquarie. The models are not a product of the Macquarie Research Department.

The quant model currently holds a marginally positive view on Aqua America. The strongest style exposure is Price Momentum, indicating this stock has had strong medium to long term returns which often persist into the future. The weakest style exposure is Valuations, indicating this stock is over-priced in the market relative to its peers.

### 197/448

Global rank in  
Utilities

% of BUY recommendations 67% (6/9)  
Number of Price Target downgrades 0  
Number of Price Target upgrades 2

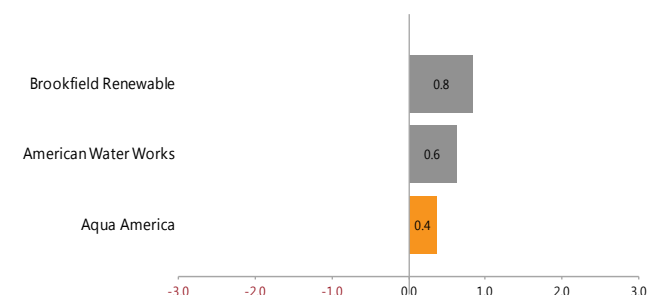


Displays where the company's ranked based on the fundamental consensus Price Target and Macquarie's Quantitative Alpha model.

Two rankings: Local market (United States) and Global sector (Utilities)

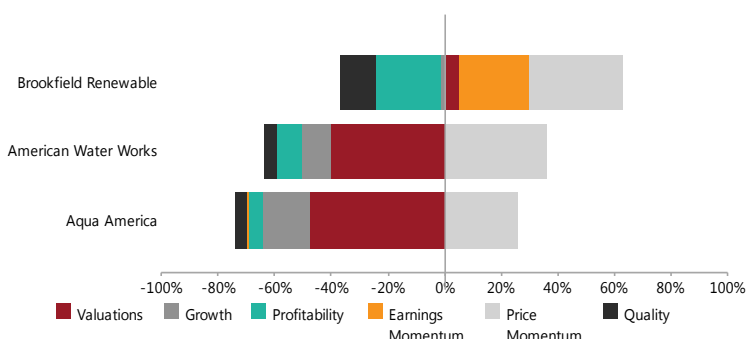
## Macquarie Alpha Model ranking

A list of comparable companies and their Macquarie Alpha model score (higher is better).



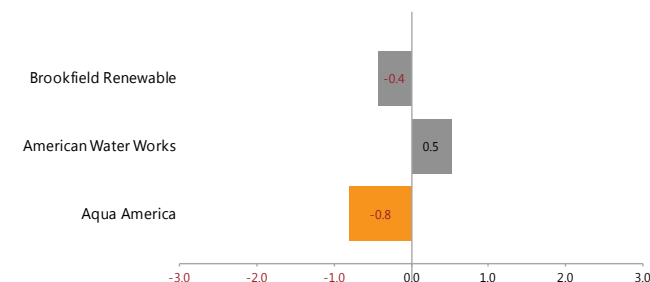
## Factors driving the Alpha Model

For the comparable firms this chart shows the key underlying styles and their contribution to the current overall Alpha score.



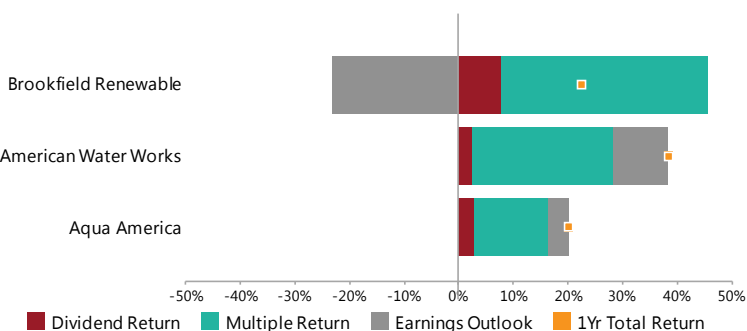
## Macquarie Earnings Sentiment Indicator

The Macquarie Sentiment Indicator is an enhanced earnings revisions signal that favours analysts who have more timely and higher conviction revisions. Current score shown below.



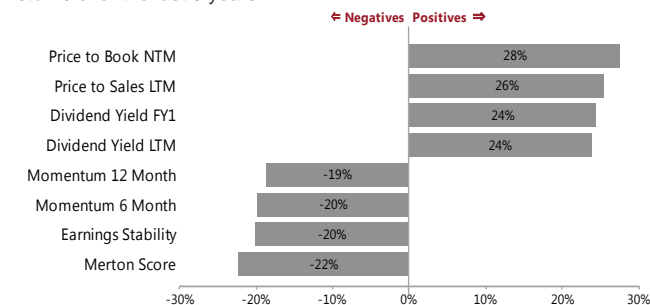
## Drivers of Stock Return

Breakdown of 1 year total return (local currency) into returns from dividends, changes in forward earnings estimates and the resulting change in earnings multiple.



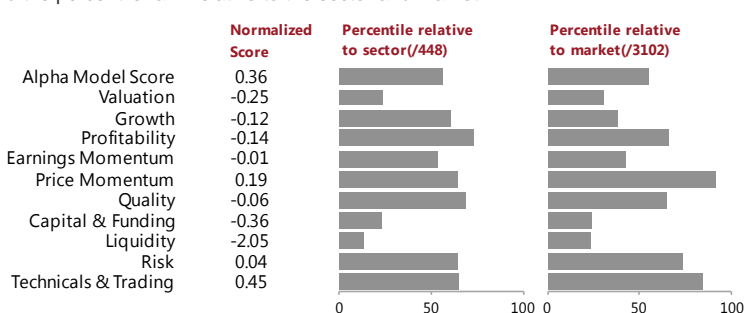
## What drove this Company in the last 5 years

Which factor score has had the greatest correlation with the company's returns over the last 5 years.



## How it looks on the Alpha model

A more granular view of the underlying style scores that drive the alpha (higher is better) and the percentile rank relative to the sector and market.



Source (all charts): FactSet, Thomson Reuters, and Macquarie Quant. For more details on the Macquarie Alpha model or for more customised analysis and screens, please contact the Macquarie Global Quantitative/Custom Products Group ([cpg@macquarie.com](mailto:cpg@macquarie.com))

## Important disclosures:

## Recommendation definitions

## Macquarie – Asia, USA, Europe and Mazi Macquarie (SA):

Outperform – expected return >10%  
 Neutral – expected return from -10% to +10%  
 Underperform – expected return <-10%

## Macquarie - Australia/New Zealand

Outperform – expected return >10%  
 Neutral – expected return from 0% to 10%  
 Underperform – expected return <0%

Note: expected return is reflective of a Medium Volatility stock and should be assumed to adjust proportionately with volatility risk

## Volatility index definition\*

This is calculated from the volatility of historical price movements.

**Very high–highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock could be speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low–medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.

\* Applicable to select stocks in Asia/Australia/NZ

## Recommendations – 12 months

**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

## Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense  
 Excluded: non-recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / efpowa\*

**ROA** = adjusted ebit / average total assets

**ROA Banks/Insurance** = adjusted net profit / average total assets

**ROE** = adjusted net profit / average shareholders' funds

**Gross cashflow** = adjusted net profit + depreciation

\*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

## Recommendation proportions – For quarter ending 31 March 2019

|              | AU/NZ  | Asia   | RSA    | USA    | CA     | EUR    |   |
|--------------|--------|--------|--------|--------|--------|--------|---|
| Outperform   | 48.45% | 56.50% | 47.06% | 51.94% | 68.53% | 51.76% | (for global coverage by Macquarie, 3.69% of stocks followed are investment banking clients) |
| Neutral      | 35.27% | 30.15% | 32.94% | 42.78% | 24.48% | 38.19% | (for global coverage by Macquarie, 2.76% of stocks followed are investment banking clients) |
| Underperform | 16.28% | 13.35% | 20.00% | 5.28%  | 6.99%  | 10.05% | (for global coverage by Macquarie, 0.89% of stocks followed are investment banking clients) |

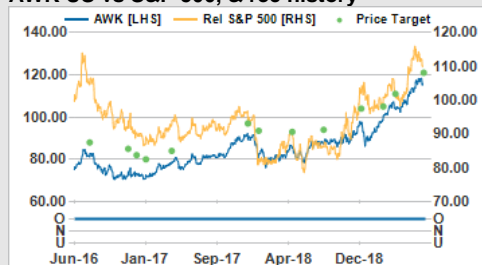
Note: This table does not reflect the announced cessation of research services effective April 29, 2019, through our affiliate Macquarie Capital Markets Canada Ltd.

## WTR US vs S&amp;P 500, &amp; rec history



(all figures in USD currency unless noted)

## AWK US vs S&amp;P 500, &amp; rec history



(all figures in USD currency unless noted)

Note: Recommendation timeline – if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.  
 Source: FactSet, Macquarie Research, July 2019

## 12-month target price methodology

WTR US: US\$38.50 based on a PER methodology

AWK US: US\$121.00 based on a Sum of Parts methodology

## Company-specific disclosures:

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| Date        | Stock Code (BBG code) | Recommendation | Target Price |
|-------------|-----------------------|----------------|--------------|
| 01-Jul-2019 | WTR US                | Neutral        | US\$38.50    |
| 22-Apr-2019 | WTR US                | Neutral        | US\$36.50    |
| 06-Mar-2019 | WTR US                | Neutral        | US\$35.50    |
| 20-Feb-2019 | WTR US                | Neutral        | US\$35.00    |
| 24-Oct-2018 | WTR US                | Neutral        | US\$34.50    |
| 05-Mar-2018 | WTR US                | Neutral        | US\$36.00    |
| 12-Dec-2017 | WTR US                | Neutral        | US\$38.50    |
| 18-Oct-2017 | WTR US                | Neutral        | US\$35.00    |
| 11-Apr-2017 | WTR US                | Neutral        | US\$33.00    |
| 18-Jan-2017 | WTR US                | Neutral        | US\$32.00    |
| 21-Jul-2016 | WTR US                | Neutral        | US\$35.00    |

## Target price risk disclosures:

**WTR US:** Our US\$38.50 TP is based on 25x our proforma '21 water EPS and 21.2x proforma '21 gas EPS. Risks include: regulatory conditions for the Peoples acquisition, outcomes of pending and future rate cases, especially in PA, cost controls, municipal M&A, and the level of market interest rates.

**AWK US:** Our US\$111 TP is based on our 2021 SOTP. Risks to the downside include: the slower pace of future municipal acquisitions, lower cost efficiencies, and slower growth in non-regulated operations.



**Analyst certification:**

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